

# JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

## 150 Years of Japan-US Relations Kan'ichi Asakawa's Predictions

by Naoyuki Agawa, Embassy of Japan

This year marks the 150th anniversary of the Treaty of Peace and Amity between Japan and the United States negotiated by Commodore Perry and Samurai officials of the Tokugawa Japan. The treaty launched the official diplomatic relationship between the two countries and opened Japan's doors to the world after almost 250 years of seclusion.

Japanese and Americans were total strangers 150 years ago. No American in Commodore Perry's expedition spoke Japanese and virtually none of their Japanese hosts spoke English – treaty negotiators were forced to work through Dutch and Chinese interpreters.

And yet, even during this first encounter of Japanese Samurai and American navy officers and sailors, there were signs of goodwill that would later develop

into a friendship between the two nations. Commodore Perry was struck by Japanese fascination about things American. He wrote in his journal that;

*"The Japanese are remarkable for their inordinate curiosity ... They were not satisfied with the minutest examination of all these things, surpassingly strange as they must have been to them, but followed the officers and men about, seizing upon every occasion to examine every part of their garments, and showing the strongest desire to obtain one or more of their buttons. Those who were admitted on board the ships were equally inquisitive, peering into every nook and corner accessible to them, measuring this and that ..."*

Despite the gunboat diplomacy manifest by Commodore and his sailors, there was also humor between the two parties. Perry wrote in his journal,

*"Of course there was plenty of Champagne and other wines with a good supply of punch for the upper table ... Matsuzaki (got) gloriously drunk, and the other three quite mellow ... At sunset*

*they all left the ship with quite as much wine as they could well bear. Matsuzaki threw his arms about my neck and repeated in Japanese as interpreted into English: "Nippon and America, all the same heart," and in his drunken embrace crushed my new epaulettes. The following day when we met at the Treaty House to conclude the business of the treaty preparatory to its being signed, the old gentleman looked quite grave, his gravity doubtless proceeding from the effects of the debauch on board ship."*

The Japan Expedition 1852 – 1854: The Personal Journal of Commodore Matthew C. Perry

The 150 years of the Japan-US relationship can be broken into three periods. During the first fifty year period (1850 and 1900), relations were excellent – the US generously helped Japan embark on modernization. Many Japanese, including leaders of Meiji Japan, studied in the United States in the fields of government, education, religion and engineering. Many Americans came to Japan to teach English, law, dairy farming and Christianity. Hokkaido, the

Currently No.49 October 2004

**Dangerous Cops: The Sequel?**  
by Marcus Noland, Institute  
for International Economics

4

## 150 Years of Japan-US Relations Kan'ichi Asakawa's Predictions

northern island of Japan, was developed with the advice of American agricultural experts. Both countries were new entrants to the world scene and engaged in rapid industrialization throughout this period.

But bilateral relations began to deteriorate gradually during the second fifty year period (1900 and 1950). Glaring at one another over their respective new territories (the US had expanded to Hawaii and the Philippines while Japan had taken over Taiwan), they saw each other as potential enemies for the first time. The period ended tragically in World War II (1941-1945) and the subsequent occupation of Japan by the US and other allied powers.

The third fifty year period started with the end of the occupation and has a remarkably successful and friendly relationship since then. Today, the two countries are the closest of allies.

And, with the terrorist attack on September 11, 2001, when Japan rushed to stand by its ally, we now seem to have started a fourth 50-year period.

What lessons can be learned from the past 150 years? What makes the bilateral relationship work so well and what can be done to make it stronger still?

These questions are not new. One person who seriously thought about these issues 100 years ago was Dr. Kan'ichi Asakawa of Yale University, born in 1873 as the son of a poor samurai. He started studying English at high school from a British teacher and went on to a Japanese university, where he proved to be an excellent student. In 1895, Asakawa went to study in the United States and received his undergraduate degree from Dartmouth College and then a Ph.D. in the study of feudalism at Yale University where he would later teach. He was teaching at Dartmouth when the Russo Japanese War (1904-1905) broke out.

Asakawa lectured around the US, arguing that Japan had gone to war because Imperial Russia's territorial expansion would not have stopped at Manchuria, but instead have gone on to threaten the rest of China, Korea, and eventually Japan. In his book (written in English), *The Russo-Japanese War*, Asakawa sought to win support from the American general public for Japan's war efforts. He lectured extensively, contrasting agrarian

Russia, an old civilization aiming at expansion on land in pursuit of a closed territory, against Japan, a country undergoing rapid industrialization and representing a new civilization that aimed at expansion in commerce seeking an open international system.

Like the US, Asakawa argued, Japan found China's territorial integrity and its open-door principle to be in its own interests and values. In short, Japan was forced to declare war on Russia because it sought peace and stability in East Asia, and Russia's relentless aggression had to be stopped. With this policy, Asakawa contended, Japan went to war against Russia – a far more formidable enemy – and won decisively. In doing so, Japan received a good deal of support from the general public in the United States.

After the war, however, Japan seemingly changed its policy and tried to monopolize the Manchurian market by refusing to withdraw its troops from certain strategic areas of Manchuria and claiming exclusive rights over certain Manchurian

“The third fifty year period started with the end of the occupation and has a remarkably successful and friendly relationship since then. Today, the two countries are the closest of allies.”

“Asakawa’s prescription for maintaining good bilateral relations between Japan in the early 20th century seems to apply to the US-Japan relationship some hundred years later.”

railroads. Japan refused to work with American businesses in developing Manchuria. American public opinion began to turn against Japan. Asakawa was deeply worried, and in 1909 wrote another book entitled, *Japan’s Crisis*.

In his book, Asakawa warned that if Japan continued its selfish policy in Manchuria, Japan would eventually be isolated in the world community and antagonize the United States, which would undoubtedly result in very serious consequences:

*“If the United States convinces itself of the injustice of the adversary and the righteousness of itself, fuels them with its unique patriotism, takes action with its wealth and might, and engages itself in a fight, no military power in the world, however strong, could possibly confront the United States with ease.*

*What Japan has to fear is not China, not the United States, not any of the other Western Powers. It should worry about putting itself on the wrong side of the cause. If the United States and Japan should fight against each other, the right cause would be*

*perceived to be on their side, not on our side, regardless of what the truth is.”*

In order to avoid such grave consequences, Asakawa argued, Japan “should most sincerely respect China’s sovereignty and most earnestly secure equal opportunities in China.” Japan should compete with the United States, cooperate with the United States, and in tandem, help bring about progress and peace in Asia.

If that is done, Asakawa wrote, “there will be neither an excuse nor half a chance for the United States and Japan to collide with each other over China.”

Asakawa’s prescription for maintaining good bilateral relations between Japan in the early 20th century seems to apply to the US-Japan relationship some hundred years later. First and foremost, a lasting friendship between Japan and the United States is based on shared interest and shared values. The two countries, both seafaring, commercial countries, have long shared and continue to share interest in an open and free international trading system. They also

share values such as human dignity, belief in the free market system, and democracy.

President George W. Bush, at the 60th anniversary of the Pearl Harbor Attack in 2001 noted at the naval base in Norfolk, Virginia, that 60 years ago the Japanese navy had attacked Pearl Harbor, but that today the Japan Maritime Self Defense Force vessels are fighting against terrorists side-by-side with the US Navy vessels in the Indian Ocean. This statement, more than any other, shows how far we have come over the past 150 years.

At this beginning of the fourth fifty year period, it is instructive to reread what Dr. Asakawa cogently wrote about the healthy and robust relations between the two countries and apply that wisdom to the future of our bilateral relationship. ■

---

Naoyuki Agawa is Minister for Public Affairs at the Embassy of Japan, Washington, DC.

## Dangerous Cops: The Sequel?

by Marcus Noland, Institute for International Economics

Like the sequel to a bad Hollywood movie, the US Treasury and its sidekick, the International Monetary Fund (IMF), are back in Asia playing “tough cop” – demanding that China liberalize its rules on international capital flows and grant foreign financial-service firms enhanced access to the Chinese market.

And once again, the United States has a tax-cutting Republican President, record-setting budget and trade deficits, and a Congress demanding that the President “do something” — about China, this time.

But there are reasons to believe that the sequel will end differently from the 1980s original.

The first time around, Ronald Reagan’s massive tax cuts created what at the time were the largest government budget deficits in US history and contributed to record trade deficits and trade tensions, most acutely with Japan. Under mounting political pressure to “do something” about Japan, one aspect of Reagan’s policy response was to initiate negotiations in 1983 over Japan’s rules on international financial flows and the access of US financial-service providers to the Japanese market. The deal accelerated Japanese capital outflows, weakening the yen and worsening trade relations.

When the talks were announced in 1983, the exchange rate stood at ¥232 to the dollar, the US trade deficit was under \$60 billion, and the bilateral deficit with Japan was \$20 billion — figures that seem almost quaint in retrospect. Within one year of the conclusion of the negotiations in 1984, the yen had depreciated to ¥265, and US Treasury Secretary James Baker was organizing with his Japanese counterpart, Finance Minister Kiichi Miyazawa, the Plaza and Louvre Accords to rein in the runaway dollar and prevent protectionist actions in Congress.

By 1987 the overall deficit stood at more than \$150 billion, the bilateral imbalance accounted for more than one-third, and farce morphed into horror flick with Secretary Baker publicly gloating that Reagan had imposed more trade protection than any President since Herbert Hoover.

Spurred by the 1988 Trade Bill, the Treasury then applied pressure to Taiwan and South Korea, demanding capital account liberalization and improved access for US financial-service providers to these markets. But these smaller, poorer economies had less robust banking systems and less sophisticated regulators. Premature capital account liberalization contributed to

financial crises in the late 1990s, which cost 10 to 20 percent of GDP.

Now at issue is whether the past is prologue: With America’s election year trade deficit heading toward \$600 billion and the bilateral imbalance with China accounting for perhaps one-quarter of the total, the Bush Administration has been under intense political pressure to “do something” about China.

Twice this year the Administration has rejected out-of-hand petitions from unions and manufacturers seeking protection from the Chinese onslaught. However, it did not dismiss the most recent section 301 trade petition, filed only a few days before a high-level Chinese government delegation arrived in Washington for the World Bank-IMF annual meeting.

So the Treasury Department is back, requesting from China the same three things it asked of the other Northeast Asians:

- a market-determined exchange rate, conflating the method of setting the exchange rate with the actual value of the currency;
- capital account liberalization, especially on the outflow side; and
- increased access for foreign financial-service providers.

Treasury Secretary Snow's recent statements follow the pattern set by his predecessors by emphasizing the desirability for China to liberalize capital market outflows and integrate foreign (read US) financial-service firms into the Chinese market. Yet the political context for these demands is quite different — unlike Japan, Taiwan, or Korea, China is not strategically dependent on the US and it will not reflexively accommodate US desires.

Despite its obvious progress, China's transition economic remains incomplete. Its economic policy-makers are handicapped by the absence of modern tools of macroeconomic management, and remain reliant on the sorts of administrative interventions that characterized the era of central planning. As a consequence, Chinese macroeconomic performance tends to be volatile, characterized by recurrent booms and busts.

At present China appears to be entering one of those turning points. China has been experiencing an investment boom for the last several years. Last year the broad money supply increased by nearly 20 percent, and by some measures, real interest rates are negative. The share of investment in GDP reached an extraordinary 47 percent. Property investment is

booming and loans outstanding hit a record 25 percent of GDP. These conditions are unsustainable (and indeed have already begun to moderate). Such rapid increases in bank lending are typically accompanied by deterioration in lending quality, and it is entirely plausible that China's state-owned commercial banks have been creating non-performing loans on a vast scale with deleterious implications for the country's financial stability.

The good news is that the slowdown that began in the first half of 2004 was a necessary and welcome corrective to the imbalances that had built up over the previous several years. But many observers are skeptical that recently undertaken administrative measures will be sufficient to produce the desired "soft landing." Under such circumstances, a revaluation of the currency could be an advisable component of a domestic adjustment package, dampening inflation and discouraging hot money inflows.

Yet the Chinese witnessed the Asian financial crisis and have seen the havoc wreaked by premature liberalization of the capital account. The health of the Chinese banking system is questionable, and depositors almost surely would reallocate away from Chinese institutions and renminbi-denominated instruments

if they were permitted to do so. This would have the twin effects of putting downward pressure on the renminbi while at the same time undermining the stability of the Chinese banking system.

Many within the Chinese government recognize that the renminbi is undervalued, and the maintenance of the dollar peg at its current level encourages speculative capital inflows that are deleterious to macroeconomic performance and the stability of the banking system. So while agreeing with the thrust of foreign demands during recent meetings in Washington, Chinese officials steadfastly refused to commit to any specific liberalization timetable.

Here in the United States, as in the 1980s, Congress is getting involved: Legislation has been introduced, which if enacted, would threaten China with WTO and IMF sanctions if it does not float its currency. The bill is currently stalled in the House of Representatives, largely because the House leadership is unlikely to do anything between now and the election to embarrass President Bush. John Kerry, has avoided signing on as a co-sponsor of the legislation in the Senate, so a holding pattern is set until after the November elections, regardless of who wins the Presidency.

## Dangerous Cops: The Sequel?

Rather than reviving the economic diplomacy of the 1980s, the next administration should push for a one-time renminbi revaluation of perhaps 15 to 25 percent under China's existing exchange rate management system. From a Chinese perspective, the revaluation would contribute to the cooling of the Chinese economy and would discourage additional speculative inflows that are affecting China's already shaky banking system. However, unlike the current Bush policy, a step revaluation would give China time to stabilize its banking system before subjecting it to the uncertainties of the international capital market.

The worst policy would be a small, say 2 percent, revaluation, which would simply signal to

speculators the existence of a one-way bet: The revaluation has to be big enough to convince market participants that it is unlikely to be repeated in the foreseeable future.

A step revaluation could also facilitate a more general realignment of Asian exchange rates, which would be a welcome component of global adjustment, as opposed to the likely short-run depreciation of the renminbi under the Bush approach. China emerged as the hero of the Asian financial crisis by not devaluing the renminbi in the midst of the turmoil. China can now reinforce that leadership by doing the opposite: revaluing the renminbi both for its own good and to ease the adjustments of its neighbors in Asia.

In the long run, greater financial integration of China with the rest of the world and greater market orientation in the determination of Chinese exchange rates are desirable. Yet as anyone in Asia who lived through the financial crisis of less than a decade ago knows, premature liberalization of the capital account has very real risks. This time around the politics are different, and so may be the outcome. ■

Marcus Noland is a Senior Fellow at the Institute for International Economics. He can be reached at: [mnoland@iie.com](mailto:mnoland@iie.com)

Publisher, Keizai Koho Center

Director, Katsunori Nemoto  
[nemotok@kkc-usa.org](mailto:nemotok@kkc-usa.org)

Editor, Valerie Ploumpis  
[vpoumpis@kkc-usa.org](mailto:vpoumpis@kkc-usa.org)

1900 K Street NW, Suite 1075  
Washington D.C. 20006  
202 293-8430

[www.kkc-usa.org](http://www.kkc-usa.org)

Keizai Koho Center (KKC) is an independent, non-profit organization designed to promote the understanding of Japan's economy and society at home and abroad. Its financial resources are derived entirely from the private sector.

KKC fosters a deeper understanding of Japan's basic social structure. Furthermore, it conducts public affairs activities to improve the Japanese people's recognition of Japan's global role.

The views expressed in this newsletter are of the contributors and do not necessarily represent those of the Keizai Koho Center.

FIRST CLASS MAIL  
U.S. POSTAGE  
**PAID**  
WOODBRIIDGE, VA  
PERMIT NO. 534